No. 95-596

Supreme Court, U.S.
FILED
OCT 12 1995
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

LEP GROUP PLC, WILLIAM R. BERKLEY, JOHN L. READ, PETER J. GRANT, JOHN R. EAST,

Petitioners,

VS.

ITOBA LIMITED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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74 pp

QUESTIONS PRESENTED

(i) Should the "precious resources" of the United States courts be devoted to regulating securities transactions, between foreigners, effected over foreign stock exchanges that involve securities that do not trade in the United States?

(ii) Should these "precious resources" be expended when no fraudulent conduct has occurred in the United States, United States markets and shareholders are not affected and no substantial United States interest is implicated?

(iii) What test should be applied by the Circuits, which are split, to offer predictability and certainty in determining the extraterritorial reach of the United States securities laws?

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OPINIONS BELOW

The decision of the United States District Court for the District of Connecticut dismissing plaintiff Itoba Ltd.'s federal securities law action for lack of subject-matter jurisdiction was rendered in an unreported decision dated March 14, 1994. A20-21.[1] The decision of the Court of Appeals for the Second Circuit reversing the district court's decision regarding the jurisdictional reach of United States securities laws was issued on May 15, 1995, and is reported at 54 F.3d 118, *reh'g denied*, __F.3d ___ (1995).

JURISDICTION

The decision of the Court of Appeals for the Second Circuit was entered on May 15, 1995. A4. Petitioners timely filed a petition for rehearing with a suggestion for rehearing *en banc* pursuant to Rules 40 and 41 of the Federal Rules of Appellate Procedure. The Second Circuit denied the petition on July 14, 1995. A1-2. This Court's jurisdiction is invoked under 28 U.S.C. § 1254. The jurisdiction of the district court was invoked under 15 U.S.C. § 78c(17).

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1 References to "A _" are to the Appendix annexed to this petition.

STATUTORY PROVISIONS INVOLVED

This case involves the Securities Exchange Act of 1934, as amended, Sections 27 (15 U.S.C. § 78aa), 10(b) (15 U.S.C. § 78j(b)), Rule 10b-5 thereunder (17 C.F.R. § 240.10b-5)) and Section 3(a)(17) (15 U.S.C. § 78c(17)), which are quoted verbatim in the Appendix. A36-38.

STATEMENT OF THE CASE

This case presents an opportunity for this Court to establish certainty in an area of the law in which predictability is essential -- the extraterritorial reach of the United States securities laws. Settling the circuit split over this issue is essential, given the increasing globalization of the world securities markets resulting from, among other things,[2] the development of American Depositary Receipt ("ADR") programs.[3]

Transactions involving ADRs effected in the United States markets have long been subjected to the application of the United States securities laws. *See, e.g., IIT v. Cornfeld*,

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2 The ramifications of the decision below are not limited to companies with ADR programs. Under the Second Circuit's reasoning, any corporation, anywhere in the world, is potentially subject to the United States securities laws if any of its affiliates have American shareholders, or if it purchases securities of any company that ever filed any documents with the Securities Exchange Commission ("SEC").

3 Foreign corporations initiate ADR programs by removing a small percentage of their stock from trading over foreign stock exchanges and depositing it with a United States bank which sponsors American Depositary Shares ("ADS") that trade over United States stock exchanges. Today, there are almost 1,000 foreign corporate sponsors of ADR programs. *See* Joseph Valli, *American Depositary Receipts: An Overview*, 17 Fordham Int'l L.J. 538 (1994).

619 F.2d 909, 918 (2d Cir. 1980); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1044 (2d Cir. 1983); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968), *(en banc)*, *cert denied*, 395 U.S. 906 (1969). However, until the Second Circuit's decision in *Itoba Ltd. v. LEP Group plc.*, 54 F.3d 118 (2d Cir.), *reh'g denied*, __ F.3d__(1995), no court ever provided a United States forum for a foreign purchaser, who purchased over a foreign exchange the securities (not the ADRs) of a foreign issuer -- simply because the foreign issuer had a small ADR program.[4]

The impact of the Second Circuit's decision in *Itoba* is broad and far ranging, not only to the growth and development of the United States and international securities markets, but also to the United States court system. The Second Circuit decision threatens to open the doors of the United States courts to foreign purchasers of foreign securities on foreign exchanges that the United States has little interest in regulating.

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[4] The number of companies this case affects is large and increasing rapidly. During the past four years, the number of foreign companies listed on the New York Stock Exchange ("NYSE") has doubled, and the NYSE's current president, Richard Gasso, is actively seeking to double foreign listings again. L. Malkin, "NYSE Is Going More Global," *Int'l Herald Tribune* (Aug. 8, 1995) (hereinafter "Malkin"). This goal will be seriously thwarted if the United States imposes its securities laws on these foreign corporations, not only for transactions on United States exchanges, but for all such foreign corporations' securities transactions anywhere in the world.

This case presents a perfect opportunity for this Court to set the metes and bounds of the United States securities laws.[5] Before this Court is a foreign issuer, LEP Group plc ("LEP"), with a small ADR program (involving less than 10% of LEP's shares), and a foreign purchaser who purchased ordinary shares (not ADRs) over the London Stock Exchange -- LEP's primary trading market. All conduct relating to these foreign securities transactions -- including the preparation of the allegedly fraudulent disclosure statements -- involved foreign corporations, acting abroad. The securities plaintiff purchased do not even trade in the United States. Indeed, the only American connection to this case is the happenstance of LEP's ADR program and the fact that plaintiff's parent corporation, a non-party to this action, has some American shareholders.

To sustain jurisdiction over these entirely foreign transactions, the Second Circuit overruled twenty years of Second Circuit precedents -- abandoning judicial analyses that were designed to create predictability in jurisdictional jurisprudence and limit the transactions litigated in the American courts to cases that implicated American interests. The Second Circuit based its finding of jurisdiction on plaintiff's claim that it derivatively relied on SEC filings made in connection with securities plaintiff did not purchase that were never intended to be and were not actually received or read by plaintiff. Premising jurisdiction on the integration of

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5 For a complete recitation of the facts of this case, defendants Berkley and Grant respectfully refer the Court to the petition for certiorari submitted by co-defendants LEP Group plc and John East.

derivative reliance principles into the jurisdictional analysis eliminates any predictability from the jurisdictional inquiry -- any foreigner who can point to an alleged American act, fraudulent or not, that potentially could affect a foreign securities market can now bring an action in a United States court by pleading derivative reliance on American activities.

The question squarely presented is whether the United States must provide a forum for investors anywhere in the world when their investment involves a company that happens to sponsor an ADR program. By resolving this question, this Court will determine (i) the appropriate level of the burden that United States courts should bear hearing lawsuits involving no American parties or American interests; and (ii) the propriety of imposing United States law on transactions over numerous foreign stock exchanges that are already regulated by foreign securities laws.

REASONS FOR GRANTING THE WRIT

I.

THE CIRCUITS ARE APPLYING CONFLICTING STANDARDS TO DETERMINE THE JURISDICTIONAL LIMITS OF UNITED STATES SECURITIES LAWS

Predictability is a predominant concern in jurisdictional analysis. As this Court has explained, a prerequisite to the exercise of jurisdiction over a defendant is that

> the defendant's conduct and connection with the forum are such that he should reasonably anticipate being haled into court there. . . . The Due Process Clause . . . gives a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimal assurance as to where that conduct will and will not render them liable to suit.

World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297 (1980) (citations omitted).[6] Extraterritorial application of

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6 *See also Jerome B. Grubart, Inc. v. Great Lakes Dredge & Dock*, __ U.S. __, 115 S. Ct. 1043, 1046 (1995) (Thomas, J., concurring in the judgment) ("This Court pursues clarity and efficiency in . . . federal subject-matter jurisdiction."); *Peralta Shipping Corp. v. Smith & Johnson (Shipping) Corp.*, 470 U.S. 1031, 1034 (1985) (Blackmun, J.).

the securities laws likewise implicates these concerns.[7] In this area in which certainty is imperative, this Court should grant this Petition for Certiorari to resolve a circuit split and allow foreign corporations and individuals who trade over foreign exchanges to structure their business affairs with minimal assurance that their conduct will or will not subject them to being haled before United States courts.

1. The Original Second Circuit Analysis, Which Was Followed By The Fifth, Seventh And D.C. Circuits

Before its decision in this case, the Second Circuit, as the pioneer court in the securities area, initially set forth the "conduct" and "effects" tests to determine when United States interests were sufficiently at stake such that extraterritorial jurisdiction was proper. After the Second Circuit set forth these standards, the Fifth, Seventh and District of Columbia Circuits adopted the test set forth by Judge Friendly. *See, e.g.*,

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[7] *See, e.g.*, Gregory K. Matson, Note, *Restricting Jurisdiction of American Courts over Transnational Securities Fraud*, 79 Geo. L.J. 141, 168 (1990) ("the courts must shape the extraterritorial application of the antifraud provisions so that decisions are consistent and principled in order to place foreign individuals on notice as to when they face liability under United States law"); Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 Harv. L. Rev. 1310, 1321 (1985) ("courts should frame a general approach that will enable multinational and foreign entities to predict the jurisdictional consequences of various actions and thus to choose among them intelligently").

MCG, Inc. v. Great Western Energy Corp., 896 F.2d 170 (5th Cir. 1990); *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27 (D.C. Cir. 1987); *Tamari v. Bache & Co (Lebanon) S.A.L.*, 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984).

As the Second Circuit recognized, "the Securities Act of 1933 and the Securities Exchange Act of 1934 are silent as to their extraterritorial application, so that the federal courts have had to determine 'whether Congress would have wished the precious resources of the United States courts' to be used in resolving disputes between foreign entities in the area of securities fraud." A10 (citing *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir.) *cert. denied sub nom., Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975)). In analyzing the proper extraterritorial scope of the United States securities laws, the Second Circuit has stated:

> Congress intended the Exchange Act to have extraterritorial application in order to *protect domestic investors* who have purchased foreign securities on American exchanges and to *protect the domestic securities market* from the effects of improper foreign transactions in American securities.

Scheonbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied*, 395 U.S. 906 (1969) (emphasis added).[8] This case

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[8] Federal courts "are not courts of general jurisdiction; they have only the power that is authorized by Article III of the Constitution and the statutes enacted by Congress pursuant thereto." *Bender v. Williamsport Area School District*, 475 U.S. 534, 540 (1986). Accordingly, this Court has repeatedly emphasized the importance of "proceed[ing] with caution in construing constitutional and statutory provisions

Footnote continued

involves neither "domestic investors" nor "domestic securities markets" and thus does not involve the principle interests the Exchange Act was intended to protect.

The Second Circuit's original analysis closely confined subject matter jurisdiction under the federal securities laws in cases involving foreign parties and foreign securities transactions.[9] The Second Circuit has required foreign plaintiffs to demonstrate that the case involves significant American activities before burdening the United States courts

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Footnote continued from previous page

dealing with the jurisdiction of the federal courts, *Victory Carriers, Inc. v. Law*, 404 U.S. 202, 212 (1971), lest the courts exercise "power the Congress has denied them." *American Fire & Casualty Co. v. Finn*, 341 U.S. 6, 18 (1950). In the extraterritorial context, the Court presumes, absent evidence of a contrary intent, that congressional legislation is meant to apply only within the territorial jurisdiction of the United States. *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949).

9 This Court recently reiterated the need for caution regarding judicial expansion of the federal securities laws when it declined to extend their reach to aiders and abettors of securities fraud, despite years of expansive decisions in the Courts of Appeals. *Central Bank, N.A. v. First Interstate Bank, N.A.* ___ U.S. ___, 114 S. Ct. 1439, 1448 (1994) ("The issue, however, is not whether imposing private civil liability on aiders and abettors is good policy but whether aiding and abetting is covered by the statute.").

with its adjudication. This inquiry focuses on the interest of American citizens in the disposition of the action.

> When, as here, a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries.
>
> Using this approach, [the Second Circuit] held:
>
> [T]he anti-fraud provisions of the federal securities laws:
>
> > (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
> >
> > (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but
> >
> > (3) *Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.*

Fidenas AG v. Campagnie Internationale, Etc., 606 F.2d 5, 9-10 (2d Cir. 1979) (quoting *Bersch*, 519 F.2d at 993) (emphasis added). Under this formulation, American courts can entertain a case brought by a foreigner and arising out of a foreign securities transaction only if substantial fraudulent "conduct" in the United States has been the direct cause of the loss, or if a foreign fraud has a substantial "effect" on United States citizens. *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991).

Under the "conduct" test as originally formulated by the Second Circuit, the relevant conduct in the United States must consist of fraudulent acts (or culpable failures to act) which are sufficient to comprise an element of an action under section 10(b) and Rule 10b-5. *See, e.g., Alfadda*, 935 F.2d at 478 ("the court has . . . jurisdiction if the . . . particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad"); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975); *Bersch*, 519 F.2d at 974. The *Vencap* court identified the specific United States interest at stake, namely preventing the United States from becoming "a base for the exportation of fraud." *Vencap*, 519 F.2d at 1017. The Court thus specifically limited jurisdiction to cases involving fraudulent conduct within the United States conduct, holding that

> Our ruling on this basis of jurisdiction is limited to the *perpetration of fraudulent acts themselves* and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries.

Id. at 1018 (emphasis added).

2. Three Circuits Adopt Different Jurisdictional Analyses

Shortly after the Second Circuit decided *Bersch* and *Vencap*, the Third Circuit, in *Securities Exchange Comm'n v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom., Churchill Forest Indus., Ltd. v. Securities Exchange Comm'n*, 431 U.S. 938 (1977) adopted a different approach. The district court in *Kasser* applied the Second Circuit's test and found that the level of conduct in the United States was insufficient to support jurisdiction under Second Circuit precedent. *See Securities Exchange Comm'n v. Kasser*, 391 F. Supp. 1167, 1175-76 (D.N.J. 1975), *rev'd*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom., Churchill Forest Indus., Ltd. v. Securities Exchange Comm'n*, 431 U.S. 938 (1977). The Third Circuit rejected the Second Circuit approach, holding that "[t]he federal securities laws, in our view, do grant jurisdiction in transnational securities cases where *at least some activity designed to further a fraudulent scheme* occurs in this country." *Kasser*, 548 F.2d at 114 (emphasis added). Thus, under the Third Circuit's formulation "fraudulent acts themselves" need not occur in the United States so long as "some activity" occurs here.

The Eighth Circuit noted the difference between the Second and Third Circuit approaches and decided to adopt its own approach. In *Continental Grain, Etc. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979), the Eighth Circuit analyzed the case law developed by the Second Circuit in *Schoenbaum*, 405 F.2d at 200, *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), *Vencap* and *Bersch*, and contrasted it with the *Kasser* decision. That court concluded, "[w]e believe . . . that the Third Circuit in *SEC v. Kasser* extended the boundaries of the necessary domestic conduct required to find subject matter jurisdiction as defined in *Bersch-IIT*." *Id.* at 418. The Eighth Circuit then set forth

its own test with respect to the level of fraudulent conduct in the United States that supports jurisdiction. *Continental Grain* held that "where defendants' conduct in the United States was *in furtherance of a fraudulent scheme and was significant with respect to its accomplishment*, and moreover necessarily involved the use of the mails and other instrumentalities of interstate commerce, the district court has subject matter jurisdiction." *Id.* at 421 (emphasis added). Thus, in the Eighth Circuit, conduct in the United States which is less than "fraudulent acts themselves" (as in the Second Circuit) but more than "some activity" (as in the Third Circuit) is necessary to support subject matter jurisdiction under *Continental Grain*.

The Ninth Circuit also noted the schism in the Circuits, and has opted for the Eighth Circuit approach. In *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582 (C.D. Cal. 1981), *rev'd*, 712 F.2d 421 (9th Cir. 1983), the district court concluded that, in the absence of controlling Ninth Circuit precedent, it would rely upon the conduct test as formulated by the Second Circuit to analyze the subject matter jurisdiction question. Under that approach the district court ultimately found that jurisdiction was lacking. *Id.* at 587-88. That Court specifically noted that "in reaching this conclusion, we recognize that the Eighth Circuit has adopted a more liberal approach to the assertion of jurisdiction in transnational securities fraud cases . . . we believe, however, that the line of cases from the Second Circuit is more in keeping with the expressions of the Ninth Circuit." *Id.* at 588.

The Ninth Circuit reversed, choosing instead to adopt the *Continental Grain* test. *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983). Noting that, "consistent with the established objectives of the federal securities laws, we have recognized that 'the jurisdictional hook need not be large to fish for securities laws violations,'" the court held that "the test for subject matter jurisdiction formulated by the Eighth Circuit . . . best satisfies those objectives." *Id.* at 424. By adopting the broader version of the conduct test, the Ninth Circuit (like the

Eighth and the Third) was able to assert jurisdiction although the *Grunenthal* facts did not give rise to jurisdiction under the Second Circuit standard.

3. The D.C. Circuit Analysis

In the wake of the line of cases employing different standards of extraterritorial jurisdiction, the District of Columbia Circuit was confronted with the issue in *Zoelsch*, 824 F.2d at 27. Judge Robert Bork analyzed in depth the development of the two jurisdictional standards that following the Second Circuit's decisions in *Bersch* and *Vencap*. The *Zoelsch* court noted that the difference between that test and the one developed in the *Kasser* line of cases is that "*Continental Grain* explicitly repudiated the Second Circuit's requirement that 'domestic conduct constitute the elements of a rule 10b-5 violation' in favor of a test that would find jurisdiction whenever the domestic conduct 'was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment." *Zoelsch*, 824 F.2d at 31. The *Zoelsch* court then observed that

> [t]he consequence of these approaches has been a loosening of the jurisdictional requirements: any significant activity undertaken in this country -- or perhaps any activity at all -- that furthers a fraudulent scheme can provide the basis of American jurisdiction over the domestic actor.

Id. Judge Bork thought that the restrictive test advocated, prior to *Itoba*, by the Second Circuit represented the better view when considering judicial restraint, the plain language of the relevant statutory provisions, legislative history and public policy issues. Concluding that the *Kasser* test constituted impermissible judicial activism, and did not necessarily reflect

the will of Congress, the D.C. Circuit decided instead to adopt the recently repudiated Second Circuit's view.

4. The Second Circuit's Abandonment Of Its Own Precedents And Creation Of The Hybrid "Admixture" Test

The D.C. Circuit's adoption of the Second Circuit view created a majority of circuits in favor of a jurisdictional analysis more closely allied to the identification of United States interests. However, the Second Circuit has now undermined the well-established jurisprudence by repudiating the tests it promulgated. The Second Circuit referred to its own prior precedents (now followed in the D.C., Seventh and Fifth circuits) as "questionable law," directly overruling the jurisdictional reasoning articulated in *Bersch*, 519 F.2d at 974. A18. The *Itoba* decision, in the view of certain commentators "represents the Court's most expansive reading of the extraterritorial reach of the federal securities laws."[10]

Recognizing that neither the "conduct" nor the "effects" test was met in *Itoba*, the Second Circuit replaced those established tests with an "admixture" test that greatly expands the jurisdiction of the United States courts for foreign purchasers of foreign securities in unpredictable ways. A10. The Second Circuit's decision sets forth an amorphous new

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10 Flumenbaum & Karp, *Extraterritorial Application of Federal Securities Laws*, N.Y.L.J., May 23, 1995 at 3; *see also* Newman & Burrows, *Extraterritorial Securities Jurisdiction: The Right Ingredients*, N.Y.L.J., May 31, 1995 at 3 (*Itoba* "appears to have enlarged the class of cases to which the courts may apply the securities laws extraterritorially").

test, lacking any predictive criteria, characterized as an "admixture" containing "a sufficient combination of ingredients the conduct and effects test." A10, A16. Had it not abandoned its prior precedents, the Second Circuit could not have sustained jurisdiction. Because the circuits are irreconcilably split, and because the question of how broadly to apply the securities laws to foreign transactions constitutes an important federal question and involves issues of international comity and judicial restraint, this Court should grant certiorari to establish the parameters of the extraterritorial scope of the securities laws. By doing so, this Court can create certainty in an area in which predictability is essential.

II.

THIS COURT SHOULD ADOPT A JURISDICTIONAL ANALYSIS THAT PROTECTS AMERICAN INTERESTS AND DOES NOT UNDULY BURDEN FOREIGN INTERESTS

Not only does the *Itoba* decision expand jurisdiction and invite foreigners to bring strictly foreign disputes into United States courts, it also usurps the ability of foreign governments and exchanges to regulate securities transactions by and between their own citizens and members. It therefore offends traditional notions of comity.

This Court has recognized that comity is an important factor in extraterritoriality analysis. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 629 (1985) ("[w]e cannot have trade and commerce in world markets . . . exclusively on our terms, governed by our laws, and resolved in our courts") (quoting *The Bremen v. Zapata off-Shore Co.*, 407 U.S. 1 (1972)); *see also Consolidated Gold Fields plc v. Minorco*, 871 F.2d 252, 263 (2d Cir. 1989), *cert. dismissed*, 492 U. S. 939 (1990) ("It is a settled principle of international and domestic law that a Court may abstain from exercising enforcement jurisdiction when the extraterritorial effect of a

particular remedy is so disproportionate to harm within the United States as to offer principles of comity."); *Timberlane Lumber Co. v. Bank of America, N.T. & S.A.*, 549 F.2d 597, 611 (9th Cir. 1976) ("The effects test by itself is incomplete because it fails to consider the other nation's interest. Nor does it expressly take into account the full nature of the relationship between the actors and the [United States]").[11] When the United States asserts jurisdiction over activities occurring within the territory of another sovereign, its action may well be perceived as intrusive and perhaps even unlawful. If comity among nations is to have any meaning, a doctrine of extraterritorially must err on the side of restraint. Note, 98 Harv. L. Rev. 1310 at 1322.

Britain, like the United States, has well developed securities markets and laws designed to regulate them, including antifraud provisions. *See* J. Ian Murray, *Globalization of Government Securities Market: The 'Big Bang' and the United Kingdom Domestic Market, the Financial Services Act, and the New Regime for U.S. Government Securities*, Practicing law Institute, PLI Order No. B4-6786

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11 *See also* 1986 ALI Restatement of Foreign Relations, providing that the exercise of jurisdiction must be reasonable. The reasonableness requirement provides that, even where the exercise of jurisdiction is otherwise permissible, the courts should decline to exercise jurisdiction or prescribe law with respect to a person or activity having connection with another state when the exercise of jurisdiction is unreasonable. Courts are instructed to (1) consider the various interests; (2) examine contacts and links; (3) give effect to justified expectations; and (4) search for the center of gravity of a given situation.

(March 20, 1987); Bernard S. Black and John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 Mich. L. Rev. 1997 (June 1994). England is capable of regulating, and entitled to regulate, its own markets and trades, like the ones at issue here, over its exchanges. Principles of comity direct that the United States attempt to respect British laws -- and Britain's ability to regulate its own citizens and markets -- rather than usurp them by exerting jurisdiction over a case that does not involve any American interests.[12]

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12 Defendants vigorously dispute the Second Circuit's characterization of the merits of this case, but respectfully submit that the merits of this action are not relevant to the jurisdictional inquiry currently before the Court. The Second Circuit has observed:

> Fraud there might have been, and plaintiffs may very well have been damaged by its perpetration. But the dispute here presented is rightfully resolved in the courts of another land.

Fidenas, 606 F.2d at 10. Furthermore, resolution of the central issue presented by this petition -- whether Itoba's purchases of LEP ordinary shares over the London Stock Exchange trigger subject matter jurisdiction under the United States securities laws -- does not depend on any activities of Mr. Berkley. Itoba did not engage in *any* transactions with Mr. Berkley and had no contact with Mr. Berkley in connection with any of its purchases. Mr. Berkley was an outside director of LEP who had no involvement whatsoever in the creating, drafting or dissemination of the disclosures Itoba now claims were fraudulent. Accordingly, it was proper for the district court to find no subject matter jurisdiction under the United States securities laws for claims asserted against Mr. Berkley.

III.

THIS COURT SHOULD ADDRESS THE BURDEN THE DECISION BELOW WILL CAUSE

Recent trends and developments in both Congress and in American culture indicate that there is a general perception that the United States federal court system is congested with a veritable explosion of litigation. In connection with various proposed reforms, members of Congress have recognized that the court system, particularly in connection with securities litigation, is needlessly overburdened with no commensurate benefit to American investors or markets. *See* Statement of Hon. Carlos J. Moorehead, 103-156 103rd Cong., 2d Sess. 1994 ("A dysfunctional securities litigation system will not promote efficient capital markets."). In addition, "fear of litigation [is] the number one problem in attracting foreign issuers into U.S. financial markets." Statement of Pete V. Domenici, 103-156, 103rd Cong., 2d Sess. at 23 (1994). Senator Domenici went on to observe that various regulatory bodies "believe the current system is interfering with the efficient operation of our capital markets." *Id.*

The strain on United States courts is readily apparent to the judiciary at large. In response to "mounting concern with the federal courts' congestion, delay, expense, and expansion" the Chief Justice of this Court conducted a fifteen month study of the problems of the federal courts. The findings were distressing: although "we may be approaching the limits of the natural growth of the federal courts. . . the surge in case filings at both the trial and especially the appellate level continues with no cessation in sight." Report of the Federal Court Study Committee (April 2, 1990) at 8. The study describes the strain on the federal system as a "crisis." *Id.* at 3. While the study did not specifically address the issue of extraterritorial jurisdiction, one of the Committee's recommendations was to reduce the federal caseload by either limiting federal diversity jurisdiction, or eliminating it altogether. *Id.* at 38-43.

In the face of overwhelming social, Congressional and judicial concern for limiting federal court jurisdiction and protecting American interests in the securities litigation area, the Second Circuit has exponentially expanded judicially that jurisdiction in *Itoba*. Indeed, the decision below effectively eviscerates previously established limits on the federal securities laws, opening up American courts to numerous actions between foreigners with no connection to the United States.[13]

Until now, the majority Circuit view was that a fraud practiced by foreigners on foreigners over a foreign exchange was only subject to jurisdiction in two circumstances: (a) if a

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13 The Second Circuit has vastly expanded the cases that can be litigated in the United States. At least 60 countries have active stock exchanges, and new stock exchanges are being established frequently. Lawrence J. De Maria, *International Report: Stock Exchanges Strong in Quarter*, N.Y. Times, Oct. 5, 1987, at D12; *Stock Exchange in Warsaw Seeks to Join Federation*, N.Y. Times, June 1, 1994, at A2; Cynthia Mitchell, *Stocking up: Soviet Georgian is in Atlanta to Learn the Securities Game*, Atl. Const., Oct. 18, 1991, at G1. This growth in the number of international stock exchanges, together with the Second Circuit's willingness to provide a United States forum for transactions on such exchanges, sets the United States courts up as the international arbiter of countless securities transactions executed between foreigners in foreign lands. But, as the Federal Court Study Committee has discovered, the federal dockets are simply too congested to undertake the role of the international securities police. In any event, there are international organizations that are assuming this role. *Global Regulation Plans Get Boost*, The Insurance Regulator, July 31, 1995, Vol. 5, No. 30 at 3.

defendant performed substantial United States activities that constituted fraud, or (b) if the defendant caused a foreseeable loss to Americans. *Consolidated Gold Fields*, 871 F.2d at 261-62. The "admixture" test adopted by the Second Circuit eliminates these objective criteria, and purports to replace them with a rationale by hindsight which provides no standards by which foreign issuers can gauge their activities. Any foreign corporation that ever filed any information with the SEC is now at risk of having to defend itself against a fraud claim under American law, even if it has no other dealings with any American citizen, corporation or government agency. The almost one thousand foreign corporate sponsors of ADR programs, with a total market capitalization in excess of one billion dollars, must now anticipate that any purchaser, anywhere in the world, who received any advice from anyone, American or not, which was derived in any manner and at any level of indirectness from information that appeared in an SEC filing, can sue in an American court. This radical expansion of jurisdiction under United States securities laws to all international activities of ADR sponsors not only contributes to an overburdened judicial system, but is directly contrary to what all evidence indicates is the will of Congress and the efforts of the NYSE to increase the number of foreign corporations who list on United States exchanges.[14]

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14 Both the NYSE and the SEC seek to increase the number of foreign corporations listing here -- the NYSE is attempting to expand its trading hours to accommodate foreign companies and has begun experimenting with trading of foreign ordinary shares in home currencies. Reuters, *NYSE to Experiment with Trading Foreign Ordinaries*, (Sept. 12, 1995). Furthermore, the SEC has loosened its accounting requirements to facilitate foreign companies listing on United States exchanges. Malkin, *supra* n.4 at 2. These efforts to encourage foreign corporations to list on United States exchanges will be seriously undermined by the Second

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Until now, the majority Circuit view was that a central component of the "effects" test required illegal activity abroad to cause a "substantial effect" within the United States. *Alfadda*, 935 F.2d at 478. The Second Circuit based its decision, at least in part, on its conclusion that the alleged nondisclosure had a "deleterious effect" on ADT's United States shareholders. A15. But neither ADT nor its American shareholders were purchasers of LEP stock, and they are not parties to this action. By disregarding the distinction between a corporation, its subsidiaries and their shareholders, and premising jurisdiction on the theory that ADT, Itoba, and ADT's shareholders are equivalents, the panel effectively expanded jurisdiction to any case involving a foreign purchaser that has an affiliate with American shareholders. Previously the effects test could not be satisfied "simply because in the long run there was an adverse effect on this country's economic interests or on American securities prices." *Bersch*, 519 F.2d at 989.[15]

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Circuit's expansion of the jurisdictional reach of the United States securities laws to trading of foreign stock over foreign exchanges because some of the foreign corporation's stock trades over United States exchanges.

15 By eradicating the corporate distinctions between ADT and Itoba, the panel also disregarded the real party in interest rule and the doctrine of *Blue Chip Stamps* -- rules that previously required that the plaintiff suffer the injury alleged. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Rock Drilling Local Union No. 17 v. Mason & Hanger Co.*,

Footnote continued

Until now, a majority of Circuits would hold jurisdiction under the federal securities laws was limited to cases in which plaintiffs could show that United States conduct was the "direct cause" of foreign plaintiff's loss. *See, e.g., Bersch*, 519 F.2d at 993; *Alfadda*, 935 F.2d at 475. The Itoba decision eliminated this jurisdictional requirement by borrowing concepts of derivative reliance from substantive to 10b-5 law. A11-12. But then concepts of derivative reliance have no place in jurisdictional analysis, when it is the actual conduct of the defendant that gives rise to jurisdiction. *See, e.g., World-Wide Volkswagen*, 444 U.S. at 286. By substituting substantive derivative reliance principles for the direct causation requirement, the *Itoba* decision opens the United States courts to any foreigner who can claim to have access to information from an SEC filing, no matter how remote.

Until now, no court has held that international securities exchanges actually constitute a single global market. The Second Circuit held that there was no distinction between LEP ADRs that traded on United States exchanges and LEP ordinary shares that traded on the London Stock Exchange because there was an alleged correlation between the trading price of these securities. A12. By equating securities that trade on domestic and international exchanges, and importing principles of derivative reliance -- principles that have expanded as a matter of substantive law to include the fraud on the market theory approved in *Basic, Inc. v. Levinson*, 485

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217 F.2d 687, 693 (2d Cir. 1954), *cert. denied*, 349 U.S. 915 (1955).

U.S. 224 (1988) -- the Second Circuit has effected a practically limitless expansion of the extraterritorial securities law jurisdiction. Any investor claiming that foreign market was somehow influenced by an ADR filing would now be entitled to a United States forum.

Plainly, the *Itoba* decision opens the doors of the United States courts wide to any plaintiff who cares to bring a securities fraud claim in connection with *any* transaction -- no matter how foreign or how tangential the American interests involved. This Court should grant certiorari, resolve the conflict in the circuits, and establish the boundaries of jurisdiction of the United States securities laws to cases

involving American interests.

IV.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully request that the Court issue a writ of certiorari.

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